There is cause for guarded optimism about Egypt's international financial condition over the next few years.

Egypt: Financial Outlook Brightens

By 1978 improved export prospects and a compromise economic reform agreement worked out with the International Monetary Fund last spring should alleviate Cairo's current foreign payments problem. The agreement, which requires a measure of austerity that the Sadat regime believes will be politically acceptable, should help regularize the flow of Arab aid and reduce the need for stop-gap financing.

Rapidly increasing earnings from oil, Suez Canal fees, and tourism will also help ease foreign-exchange constraints. As a result of improved economic management and brighter financial prospects, Cairo will probably be able to attract additional private investment and maintain a substantial real growth rate between now and 1980.

Background

Egyptian imports have soared since 1972. Between 1972 and 1974, they more than doubled, and the financial gap—the current-account deficit plus amortization of external debt—swelled to $2 billion. Arab aid has by and large filled the gap, but the stop-and-go nature of that aid has led to a series of financial payments crises for Egypt.

For a brief period following the 1973 war, Egypt was able largely to ignore its financial gap. Arab affluence, Egypt's pivotal position in the Middle East, and President Sadat's efforts to undo many policies begun in the Nasir years brought a record inflow of cash and credit.

But the Arab donors substantially stiffened their aid terms in 1975. Although Arab disbursements to Egypt for the year amounted to $2.5 billion, insufficient amounts were transferred in the first half of the year to forestall a liquidity crisis.

To avoid another payments crisis in 1976, Cairo was forced to defer repayments on $450 million in short-term debt-service obligations and draw down inventories of imported goods rather than place new import orders. The financial gap was held to $2.7 billion, and the current-account deficit was kept to about $2 billion.

In late 1976, in exchange for Arab emergency aid, the Sadat government agreed to more rapid implementation of economic reforms recommended by the International Monetary Fund. The result, in January of this year, was a badly bungled attempt to reduce consumer subsidies and the worst urban riots in two decades.

The New IMF Agreement

Armed with the threat of further civil disorders, the Sadat government has negotiated a compromise agreement with the IMF requiring:

- A devaluation of the Egyptian pound.
- A modest reduction in existing price subsidies, exempting for the time being such politically sensitive items as wheat.
- A reduction in the public-sector deficit by increasing revenue collection from higher income groups through tax reforms, tariffs on luxuries, and a crackdown on tax evasion.
- A limit on foreign borrowing, especially on the use of high-cost, short-term bank loans as a means of financing the government's international obligations.

To compensate in part for the decline in real wages inherent in the above terms, the agreement permits substantial pay increases for public-sector workers and a rise in private-sector wage ceilings.

Living up to the agreement is proving difficult. For one thing, Egypt had been counting on increased revenue collection and falling prices of imported wheat to reduce the size of subsidy cuts needed to comply with IMF guidelines on expenditures. So far, these improvements have not been sufficient to offset above-budget expenditure by some government departments during the first half of 1977.

Other ways of reducing state spending would be both politically and economically disruptive. Cairo is particularly reluctant to cut government investment spending, which remains the main element in this year's expected 6-percent gain in real gross national product.

1977 Payments Outlook

The financial gap will probably reach $3.7 billion this year. Most of the increase will reflect higher debt amortization costs, particularly repayment of short-term debt accumulated last year.

Under the terms of the IMF standby agreement, Cairo is obligated to repay $700 million of this debt and an additional $800 million in medium- and long-term obligations by the end of 1977. Most of the outside support needed to meet these payments and cover the remainder of the financial gap has already been lined up.

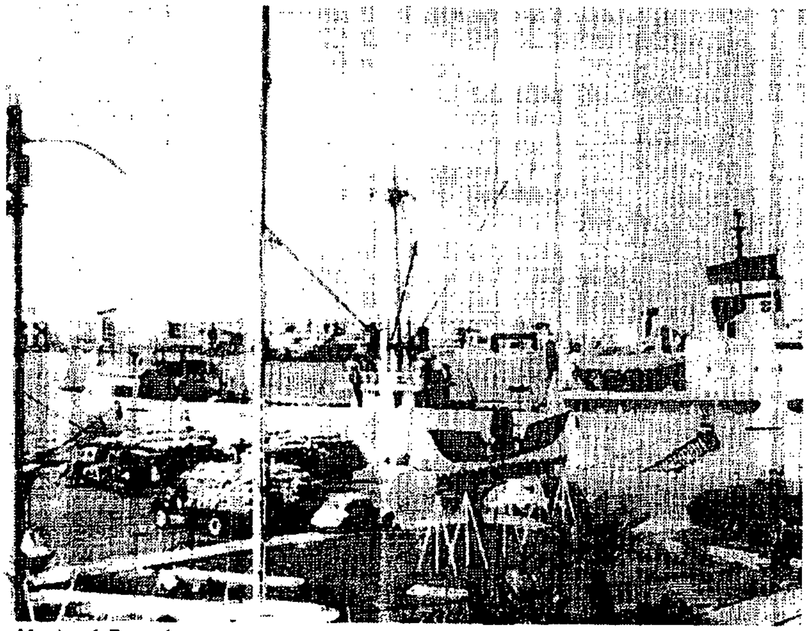
About $2.5 billion has been committed by Arab states, and limited additional Arab funds may be forthcoming. Another $1 billion or so has been committed by US and other Western sources.

Despite another surge in imports, the 1977 current-account deficit will probably be held to $2.2 billion, only slightly above the 1976 level. The import bill will increase, perhaps to $5.7 billion, partly reflecting the need to rebuild inventories of industrial raw materials and intermediate goods drawn down during last year's exchange squeeze.

Although price hikes associated with the devaluation of the Egyptian pound will help contain the growth of purchases of foreign goods, pent-up demand for consumer durables remains strong. Altogether, the probable level of imports for the industrial sector should support real GNP gains of about 6 percent in 1977.

Rapidly increasing foreign exchange earnings will offset most of the estimated $1-billion rise in import costs this year. The discovery of a new high-pressure area in Amoco's "July" oilfield in the Gulf of Suez has already pushed Egyptian oil output up one-third over the 1976 level of 330,000 barrels per day; output may approach 500,000 barrels per day by the end of the year.

As a result, net foreign exchange earnings from oil should increase by about $300 million this year. Increased receipts from tourism and another record increase in Suez Canal revenues will boost net service earnings this year to $1.1 billion, compared with $900 million in 1976 and $450 million in 1975.



Much of Egypt's current surge of imports flows through Alexandria's port area

Future Prospects

The financial gap should begin to diminish in 1978, dropping to perhaps $2.6 billion. The Egyptians have probably already lined up as much as $1.5 billion in aid commitments to finance the gap.

The big change again in 1978 will be in debt amortization costs, which should be cut roughly in half, to $700 million. A projected $300-million gain in net oil receipts will bring the current-account deficit below $2 billion for the first time since 1974—if imports are priced at the depreciated exchange rate and nonoil exports hold steady. At this time, the major risk is that falling cotton prices will offset the gain in other nonoil exports, which are benefiting most from the currency change.

This pattern of a diminishing external gap should hold through 1980. Aid requirements will tend to shrink faster than the overall gap, especially if foreign investment picks up in response to improvements in the Egyptian investment climate. Foreign investment in sectors like oil and tourism that already have a high degree of foreign participation should continue to increase, barring political upheaval or war. Cairo will also benefit from increased remittances from Egyptians working in other Arab countries.

With foreign exchange constraints thus eased, the economy should be able to grow at about the 6-percent rate at which it grew between 1975 and 1977. Much of the growth will continue to be concentrated in the Suez area and "frontier" regions on the Red Sea coast and west of Alexandria. Growth in the interior will be limited by lack of private investment opportunities, congested living conditions, and obsolete transportation and communications facilities.

Egypt's ability to sustain growth and payments gains beyond 1980 is doubtful, however. Quite likely, the tourist and canal traffic booms will be leveling off by the end of this decade. If major new oilfields are not discovered quickly, growth in oil output also may come to a halt.

New export markets will have to be developed if Egypt is to sustain growth of 6 percent and reasonable balance-of-payments stability. This in turn will require rapid expansion of export-oriented industries—preferably labor-intensive—and accelerated development of the small private sector. Although reform measures taken by the Sadat government over the past several years provide some incentives, more basic bureaucratic and institutional reforms are needed to spark the development of a broad-based private sector.